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American Institute of Certified Public Accountants (AICPA)

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## ACCOUNTANTS' LIABILITY

The number of complaints against professional accountants and the amounts of recovery sought have increased each year for the past 15 years and can be expected to continue to increase. These somber comments were made at the New England Graduate Accounting Study Conference in June this year by Donald J. Schneeman, secretary and general counsel of the AICPA.

Some of the reasons why Mr. Schneeman expects this trend to continue are that the contingent fee system favors bringing legal claims of doubtful merit, and juries, in addition to compensating for loss, tend to punish when they find the defendant to be in the wrong. Also, there is a general distrust of institutions now, and clients and the public no longer feel restrained from suing professionals.

The result, says Mr. Schneeman, is that to a large extent the duties and responsibilities of the CPA are being developed and set by the courts rather than by the profession.

Nevertheless, while there is little hope for a lessening of claims against CPAs, Mr. Schneeman believes that defenses that can be asserted against unreasonable claims should be stronger than in the past. This is because the quality of practice is at a higher level (CPE, peer review, etc.) and auditing and accounting standards are more precise.

Mr. Schneeman presented for discussion several case studies derived from actual experience. In most of them, no specific solution was offered. The following two are presented in summary form.

### *Case Study 1*

A father and son were seeking to purchase a going business which would provide Son, who would be active in the business, with a living wage. They responded to an advertisement offering an agricultural nursery for sale. Preliminary discussions were held with Seller who represented that the nursery produced weekly gross sales of \$3,200.

Father and Son investigated Seller's home and lifestyle and, on assurance of Seller that Nursery was his sole source of income, decided that the business seemed to meet their goal.

Father engaged CPA to review the books of the nursery. CPA found that books and records of the business were inauditable. Single-entry bookkeeping method was used, cash receipts did not tie in with bank deposits, payroll record did not coincide with payroll tax returns, cash register tapes were unintelligible and there was no lock on the cash register. CPA concluded that there were many opportunities to take cash out of the business or put cash into the business without a proper entry being made on the books and records.

CPA advised Father and Son of his findings, told them that he could not vouch for the figures of Nursery. Seller had represented to Father that weekly gross sales were \$3,200 and CPA suggested that Son sit at the cash register for a week to verify this. Father asked CPA to frame a projection using the \$3,200 figure. CPA had a partner whose father had been in the nursery business and who supplied figures for the costs of materials purchased and other projections for CPA to use in his computations. The projection, showing anticipated profits of \$29,000 a year, was prepared by CPA who, in delivering it, said that the \$29,000 sum would hold if all the figures were true and correct—which he could not vouch for since he was aware of off-the-

### **What's Inside . . .**

- ☐ Obtaining guidance in small practice management, p.2.
- ☐ Improving the quality of your life, p.3.
- ☐ Initial fun, p.4.
- ☐ Some new television programs, p.4.
- ☐ How to get out of your own way, p.5.
- ☐ PCPS simplifies peer review requirements, p.7.

book cash payments to employees and suppliers.

The sale was completed, a double-entry bookkeeping system was established and for the first 40 days of operation, the business did \$16,338—very close to the projected \$3,200 a week. Cost of supplies, however, ran about 40 percent of gross sales rather than the expected 20 percent. And it was discovered that cash payments to employees and suppliers were much heavier than expected. In addition, Son was hiring new employees and attempting to expand the business. The increased operating expenses required Father and Son to put additional capital into the venture. Nursery closed six months later and Father and Son sued CPA for negligence in the preparation of the forecast and sought damages of \$140,000.

Assuming all the necessary facts are contained in the above narrative:

- (1) If you were CPA, would you have done anything differently?
- (2) If so, what?
- (3) If asked to advise CPA's insurance carrier, would you advise litigating or settling?

### *Case Study 2*

Dr. Eye Glass practiced his profession as a professional corporation and consulted his CPA with regard to the purchase of certain optical equipment. CPA told him that the equipment could be (1) leased from the manufacturer, (2) purchased by the professional corporation or (3) purchased personally and leased to the professional corporation. CPA recommended the third option, and the purchase and lease were executed. In preparing Dr. Glass' personal income tax return, CPA included expenses for the equipment, rental income for the equipment and claimed an investment credit of \$2,532.

The IRS has disallowed the investment credit and Dr. Glass has sued CPA for the \$2,532 plus penalties and interest.

### *Questions*

- (1) What should CPA have advised Dr. Glass in the first place regarding the third option?
- (2) How should the insurance carrier respond?

## **The Shoemaker's Children**

There are probably few CPAs in public practice who would question that the profession is in an era of rapid change, and that the flow of information from state and national organizations pertaining to new policies and procedures is moving at an unprecedented pace.

However, it is my contention that because of the time needed to keep up with this flow of data in order to be aware of new developments, as well as the time spent serving clients, practitioners in small practice units are neglecting their practices. After all, if one has only a certain amount of time to devote to one's work, the general belief is that it be spent improving client service rather than finding ways to run the practice more efficiently.

No doubt, many CPAs realize that it is essential for the well-being and long-range growth of a small practice unit that time be set aside to implement quality control procedures and improve its management. The question which may be raised is, how best to go about it? One can do it alone or, as many firms are doing, participate in the AICPA's local firm management review program. (In this program, a firm's operating procedures are evaluated by reviewers based on a checklist developed by the AICPA MAP committee.) Another alternative is to contract with an accounting firm consultant for guidance in the development and implementation of needed improvements.

In our complex society, specialists are needed to delve deeply into areas that require more time and greater expertise than can be supplied by a generalist. This is true of the medical field, and in our profession many firms have partners and staff people who specialize in complex areas. In small practice units, the practitioner must be much more than a specialist and must cope with problems involving personnel, billings, collections, timekeeping and library maintenance, etc. Usually, the added burdens mean time restraints on family life, sports and social activities.

Recognizing these problems, a new breed of

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practitioner has evolved—the accounting firm consultant who provides his clients with management expertise. Often, the consultant can, as an outsider, make suggestions and offer solutions that would otherwise be unacceptable to some partners or staff members.

Ideally, the consultant should be able to offer a broad background of experience in practice management, staff training and scheduling, and in reviewing workpapers and financial statements. Specifically, the following outlines require the most intensive review for a small practice unit and are areas in which a consultant can be of great help in developing cost-effective improvements.

#### *Practice management.*

- ☐ Personnel testing and hiring.
- ☐ Preparation of personnel manual.
- ☐ Timekeeping methodology, fee setting, billing and collection procedures.
- ☐ Leasing and/or purchasing of office equipment and facilities.
- ☐ Purchasing supplies (taking quality, price and the firm's image into consideration).
- ☐ Advertising philosophy—methods and layout.
- ☐ Professional and liability coverage.

#### *Technical skills.*

- ☐ Improving firm's policy manuals.
- ☐ Preparing quality control documents and implementing quality control procedures.
- ☐ Creating and using engagement letters.
- ☐ Creating workpaper formats for recurring engagements.
- ☐ Updating professional library materials.
- ☐ Implementing new policies and guidelines involved in compilation and review of unaudited financial statement engagements.
- ☐ Preparing financial statements and maintaining ledgers using a minicomputer or a service bureau.

#### *Staff training and scheduling.*

- ☐ Complying with state CPE requirements.
- ☐ Reviewing client problems and acquiring skills commensurate with clients' needs.
- ☐ Implementing in-house training courses, through the use of AICPA and other materials, in the most convenient method for the firm.
- ☐ Creating cost-effective scheduling methods.
- ☐ Maximizing partner's time. (Become a specialist or remain a generalist.)

Practitioners who are not convinced that improvement in the above areas will help them do a

better job for their clients and improve the efficiency and profitability of a small practice unit might find an analogy in the fable of the shoemaker's children. The poor shoemaker spent all his time making shoes for his customers so that he was unable to make any for his own children. Ironically, they went barefoot!

—by Sheldon Ames, CPA  
Cleveland Heights, Ohio.

## **Managing the Quality of Your Life**

If you fly off the handle rather easily, have trouble falling asleep, or find that you're too busy to eat, keep in mind that these things can happen to all of us on occasion. But, if they occur frequently they might be symptoms of an inability to cope with stress.

Stress and the workaholic syndrome are part of some CPAs' lives. They are factors that can lead to family problems, loss of productivity and may-be even premature death.

All of us want to lead productive lives, both professionally and personally. Achieving what we want can be a struggle though, particularly if we grapple with the problems on our own.

The AICPA Management of an Accounting Practice Committee is offering members the opportunity to profit from the guidance of consultants who are trained to help people resolve conflicting pressures and goals. This opportunity will take place at the committee's first Quality of Life seminar which will be held at the Denver Marriott Hotel on January 20-22, 1980.













The seminar has been specially tailored for CPAs and their spouses. It offers practical ways to set more rewarding goals, handle stressful situations, increase productivity, improve physical fitness and develop an effective financial plan. The recommended CPE credit is nine hours.

The registration fee is \$225 per person, \$375 per couple (CPA and spouse) which covers all sessions, materials, two luncheons, one dinner and refreshments. Hotel accommodations and other meals are not included.

*Registrations for the seminar should be made through the AICPA meetings department. Hotel reservations should be sent directly to the reservations department, Marriott Hotel, 6363 East Hampden Avenue, Denver, Colorado 80220 (303) 758-7000.*

## When CPAs get together initially

by Paul Browner

 Charlie is our managing partner!	 Paul just finished reading SSARS no. 1!	 Don't mention "tax season" in front of Arthur!
 That's the last time Calvert will "low-ball!"	 I understand that Perry does a lot of write-ups!	 Alan, here, has decided to advertise!
 One more part to go, huh, Aubrey?	 I never realized the profession was getting so crowded!	 Philip thinks that "debit" is near the door!
 Clarence is a specialist in data processing!	 Al's our audit manager!	 Parker was just displaced by a large firm!

### New Idea in Continuing Professional Education

Are you bored with the same old television programs night after night? Has that videotape player you bought to relieve the boredom proved to be a nine days' wonder? Well, don't give up. The AICPA has developed a new concept in continuing education that makes good use of your home entertainment equipment.

Marketed under the name of VideoFlex™, the new programs consist of color videotapes (¾ inch U-matic, ½ inch Betamax or ½ inch VHS cassettes) and coordinated workbook manuals. The only equipment you need to put on a program is a standard color television set and a videotape player which can be rented or purchased locally if you don't already have one.

VideoFlex™ is designed for use by one person or a group—a feature that makes it doubly attractive to small firms who may want to reduce training costs by eliminating instructors' fees and other expenses involved in attending out-of-office seminars or workshops.

Each program includes a coordinated manual containing essential advance preparation material, a transcript of the videotape presentation, a workbook and a quiz that may be submitted for a certificate of completion. The videotape portion of the program usually illustrates problems and situations encountered in a particular area of accounting and how they can be handled or solved. During the presentation, a moderator asks questions, makes observations and advises what action should be taken. Participants are also instructed to consider how they would deal with the problem at hand.

Other attractive features about the format are that if a point is unclear or merits discussion, the tape can be stopped or replayed, and also, the programs can be scheduled at the most convenient time for all concerned.

So, if the standard television fare is not to your liking, turn on your own program and earn yourself some CPE credit at the same time.

For more information about the VideoFlex™ programs, contact the CPE marketing department at the AICPA (212) 575-6643.

## Achieving Your Potential

Have you ever wondered why some people seem to be happier, more productive and more fulfilled than others? And, have you ever considered that most of the barriers to personal growth and development might be self-imposed?

Here's another question. Have you ever asked yourself, "Why do I act the way I do?" Surely, if we know how our minds work and why we do things, we can change our habits and attitudes. Then, if the barriers to personal development are self-imposed, we can erase them and become happier, more fulfilled people.

We are all products of our own thinking in that our self-images (our opinions of ourselves) control the ways we act. These self-images affect our performances, because we tend to do only those things that allow us to feel comfortable—in order to conform to the image we have of ourselves. Because reaching out may cause us to move out of our comfort zones, we may choose to remain the same to avoid any stress and tension.

How do we start making changes in this behavioral pattern? Well, one way is by changing the pictures we have of ourselves. We are in total control of ourselves through our thoughts, and, if we can imagine ourselves with new characteristics, in new situations, etc., we can beat the feeling of being uncomfortable. If we can learn how thought control holds us back, we can do something about getting where we want to go.

The way that we think is controlled by the mental conversations that we have with ourselves. Most adults are restricted because they have poor self-images, try to stay comfortable and don't set adequate goals. Children are not like this. They are motivated by what they want. (They have not yet learned to limit themselves.) As adults, however, we avoid situations where we think we will be embarrassed, and so we're trapped into using poor images because of things that happened to us in the past.

We develop scotomas to the truth about the world and ourselves because of preconceived ideas and conditioning. These blind spots cause us to

- ☐ See what we expect to see.
- ☐ Hear what we expect to hear.
- ☐ Think what we expect to think.

*An exercise demonstrating the effect of conditioning appears on page 6. Read it carefully and then count the number of Fs in it.*

Since we are a product of our thinking (as we think we react), it is very important that we under-

stand the thought processes. Put very simply, there are two levels or spheres to the mind—the conscious and the unconscious—which, although not operating independently, have different but associated functions. Each level possesses separate and unique qualities and powers. There are three processes involved; let's take a look at them.

*The conscious* part of the mind perceives, interprets and maintains contact with reality through the input of the five senses. The conscious has four functions:

- ☐ *Perception.* We gather input based on our personal interpretation of reality. Unfortunately, our perception is not always completely accurate.
- ☐ *Association.* All new information received is immediately associated with our accumulated storehouses of perceptual impressions.
- ☐ *Evaluation.* The input is then evaluated with reference to its associations for us. We compare the new data with previous information and experience. We want to know what it is probably leading us towards and how the new information compares with what we already know.
- ☐ *Decision.* We decide on a course of action, reaction or inaction based on our immediate needs and goals. We may choose to take some action, make further consideration, let someone else make the decision, or ignore or repress the matter.

*The subconscious* mind stores our interpretation of reality. This process is operating even before birth. The subconscious mind records all of our experiences, what we think about them and say to ourselves in relation to them, what we imagine about ourselves in these experiences and our emotional reactions to them.

We might think of the subconscious as a blank canvas at birth, to which we add brush strokes, as we begin recording our experiences, to our picture of reality which we call the truth. However, this may only be the truth as seen through the eye of the beholder. We must remember that we store not only the information of the experience but, also, how we feel emotionally about the experience.

This means that our picture of reality may be distorted, inaccurate and prejudiced compared with an objective interpretation of our reality. In any event, once we assume attitudes and opinions about ourselves, we are stuck with them until we consciously decide to change them.

Our subconscious minds work like computers regarding the input of data. To use computer ter-

minology, if you program garbage in, you get garbage out (the GI-GO concept). Similarly, the subconscious does not make value judgments about the information it receives. If we have recorded negative attitudes and opinions about ourselves regarding our abilities and potential, we have formed a poor self-image and can only act in a manner that will match our picture of the truth. Consequently, to the degree that our picture of truth and reality is founded on misinformation, our corresponding behavior and actions will be unsuitable or inaccurate.

The second function of the subconscious is to handle automatic processes such as breathing, digestion, etc., and the learned automatic functions such as walking or driving a car. These learned activities begin on the conscious level but through repetition become habitual and are eventually turned over to the subconscious level. These behavioral habits are known as free-flowing operations because we do not have to consciously think about them before doing them.

Most of the time, habitual behavior helps us function in an efficient manner. However, some habits stored on the subconscious level can be barriers to our need to change or adjust to new situations and experiences. We may fall into the trap of trying to use old and irrelevant habit patterns to deal with new experiences and challenges.

Old and inappropriate habits, attitudes and opinions are often the reasons why adjustment to a new situation or intellectual challenge is difficult and causes anxiety and stress. To the degree that habitual behavior locks out new options for change, growth and progress, it is a limiting factor in developing and utilizing one's potential to the best advantage.

*The creative subconscious* has three functions:

- ☐ It maintains our reality by making us act the way we see ourselves. This picture is based upon the currently dominant image of the truth as recorded from our subjective interpretation of the world.  
For example, if we see ourselves as poor public speakers, our creative subconscious will cause us to stammer or be nervous during a speech. In effect, our creative subconscious keeps us acting in a manner consistent with our subjective subconscious pictures.
- ☐ It solves problems by scanning the data bank of stored information in the subconscious. Then, the creative subconscious pieces together seemingly unrelated bits of information into possible answers and solutions.

- ☐ It provides psychological drive and energy to resolve conflicts or accomplish goals. The challenge that is presented to the creative subconscious causes psychological disharmony, and in order to regain it, we work towards finding a solution.

It is not possible to hold conflicting thoughts without creating emotional disharmony. A change in behavior or attitude is usually required to lessen the condition. People always seek to maintain a psychological balance by attempting to fit things together logically. The most common way is through rationalization.

People rationalize when they attempt to explain their thinking or actions in terms of logical or justifiable reasons for their opinions or conduct. Before making a commitment or decision, people usually go through a stage of exploring and evaluating the overall situation and are open to new information and experiences. As soon as the decision is reached or the commitment made, however, we begin to gather only those people and facts that support our opinions and conduct. This process is called clustering.

Once people adopt an attitude, it is very difficult for them to see another's point of view. We constantly seek verification for our decisions by gathering information that makes us feel good about them. Shortcomings are rationalized or repressed and not dealt with on the conscious level.

Very often, our old attitudes and habits set the pattern for our future performances. This is because whatever we believe about ourselves, our situations and our potential, we will creatively work to make come true.

The creative subconscious is powerful and can work for either destructive or constructive goals, since no attention is paid to whether or not we are acting in our own best interests. It brings reality into our subconscious picture, regardless of our true potential.

Finished files are the result of years of scientific study combined with the experience of many years.

*This article is based on material supplied by The Pacific Institute, Incorporated, Seattle, Washington. It is the first of several features giving insights into why we think, feel and act the way we do, and providing tools necessary to make the changes we wish to make in order to achieve personal, family and business goals. By the way, six is the answer to the above exercise.*



## PCPS Simplifies Its Peer Review Requirements

In response to the suggestions of local practitioners, the peer review committee of the private companies practice section (PCPS) is issuing revised guidelines to simplify the documentation required of smaller firms for peer review.

Under the new guidelines, which apply to PCPS member firms with up to about 20 professionals, a quality control document is no longer required

for a peer review. A simple questionnaire to be completed by the firm replaces the quality control document.

Also, the emphasis is now on reviewing selected accounting and auditing engagements for evidence of effective quality control rather than on the documentation of policies and procedures.

In addition, the new guidelines specify the following minimum documentation required for the nine quality control elements identified in SAS no. 4 and cited in the *Peer Review Manual*.

<u>Quality control element</u>	<u>Minimum documentation</u>
1. Independence	A memorandum of inquiry, or written representations from professional personnel, or similar evidence that the firm monitors compliance with independence policies and procedures.
2. Assigning personnel to engagements	None.
3. Consultation	An adequate reference library or access thereto.
4. Supervision	Written audit programs (see SAS no. 22).
5. Hiring	Personnel files that include an application, resume, or similar document.
6. Professional development	Documentation adequate to support the firm's annual education report to the section.
7. Advancement	Personnel files that include at least an annual evaluation form or memorandum.
8. Acceptance and continuance of clients	None.
9. Inspection	Memoranda summarizing inspection results and the actions taken on those findings.

There were many questions raised at the conference for members and prospective members of the PCPS in Reno earlier this year concerning membership and membership requirements, peer review, sanctions, the executive committee and accounting and review services.

Here are a few of the questions relating mainly to peer review. The answers are informal and should not be regarded as official pronouncements of the Institute.

**Q** Are there plans to extend peer review to tax and management advisory services? If not why not?

**A** To a large extent the peer review program was developed because of the obvious public interest in the reliability of financial state-

ments with which a CPA is associated. This third party reliance is not usually a factor in tax and management services. There are no plans to include these two services in peer review.

**Q** Who reviews a firm that belongs to both the PCPS and the SECPS?

**A** Reviews of firms that are members of both sections and that have five or more SEC clients will be conducted by the SECPS. Under a concept that was recently approved, reviews of all other firms that are members of both sections are expected to be administered by the PCPS and will be conducted in accordance with SECPS standards.

**Q** Who pays for a peer review and how much does it cost?



- A** The reviewed firm pays. For reviews conducted by teams appointed by the PCPS peer review committee, the cost includes (a) time charges, currently \$45 per hour for a review captain, \$35 for other team members; (b) a 10 percent surcharge on the time charges; and (c) out-of-pocket expenses. These arrangements may vary for firm-on-firm reviews and for reviews conducted under the auspices of a state society or association of CPA firms.
- Q** How soon after I join the PCPS must I have my peer review? How long must my quality control policies and procedures have been in place when I have my review?
- A** The peer reviews of all firms that joined by mid-1979 must be completed by June 30, 1982. The peer reviews of firms that join later must be completed within three years after they join. Your quality control policies and procedures should be in effect six months before your review, although you can modify them during those six months.
- Q** How will PCPS peer review reports be publicized?
- A** The report itself (but not any accompanying letter of comment) will be available for inspection in the public file at the AICPA's offices in New York. The AICPA will make no further distribution of it, and will not mail copies to anyone. The reviewed firm is free to publicize the results of the review and distribute copies of the report.
- Q** My firm employs several paraprofessionals who provide client service. Must they meet the CPE requirements?
- A** It is not possible to give a simple answer because there is no generally accepted definition of a paraprofessional. All persons whom the firm classifies as professional staff are subject to the CPE requirements. This determination is intentionally left to the firm itself.
- In general, the CPE requirements are meant to apply to CPAs and prospective CPAs, and to others with a similar amount of academic preparation with emphasis in other areas that are part of CPA practice. Paraprofessionals who perform only work of a clerical nature that is reviewed by a professional are not subject to the CPE requirement; neither are employees not involved in client service.
- Single copies of the complete report containing the questions and answers are available at no charge from the PCPS of the AICPA Division for CPA Firms.

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